(29)

No. 91-615

In The
Supreme Court of the United States
October Term, 1991

Allied-Signal, Inc., as successor-in-interest
to The Bendix Corporation,
Petitioner
v.
Director, Division of Taxation,
Respondent

On Writ of Certiorari to the Supreme Court
Of the State of New Jersey

SUPPLEMENTAL BRIEF OF AMICI CURIAE IN SUPPORT OF DIRECTOR, DIVISION OF TAXATION OF THE STATE OF NEW JERSEY BY THE STATE OF CALIFORNIA AND THE STATES OF ALASKA, IDAHO, KANSAS, MAINE, NEW HAMPSHIRE AND VERMONT

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(Continued on inside cover)

38

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QUESTIONS PRESENTED

1. Should the Court overrule *ASARCO Inc.* v. *Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co.* v. *Taxation and Revenue Department of the State of New Mexico*, 458 U.S. 354 (1982)?

2. If *ASARCO* and *Woolworth* were overruled, should the decision apply retroactively?

3. If *ASARCO* and *Woolworth* were overruled, what constitutional principles should govern state taxation of corporations doing business in several states?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES:

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INTEREST OF AMICI CURIAE

Amici are states which compute the individual tax liabilities of multijurisdictional taxpayers under the "unitary

business principle."[1] Among amici, the "unitary business principle" is applied in virtually all of its variants including the "single entity" and "combined report" forms. Amici share with New Jersey a common concern as to the limits upon state income taxation which arise from the Due Process Clause and Commerce Clause of the Constitution. In particular, amici are concerned with the Due Process Clause and Commerce Clause standards for determining when income arising from the ownership of intangible property can be subjected to apportionment.

Amici have a direct interest in the clarification of the questions raised by the Court in its order for reargument in this case. The resolution of these questions affects billions of dollars in state taxes annually. Amici have a particular interest in the clarification of the proper application of this Court's decisions in *ASARCO Inc.* v. *Idaho State Tax Commission*, 458 U.S. 307 (1982) and *F.W. Woolworth Co.* v. *Taxation and Revenue Department of the State of New Mexico*, 458 U.S. 354 (1982), and more specifically in whether or not it is necessary to establish that there is a "unitary business" relationship between the holder and the issuer of an intangible in order to subject income from that intangible to apportionment. Amici believe the Court should overrule both of these cases.

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[1] The unitary method includes both formulary apportionment and combined reporting. Every jurisdiction uses some type of formulary method to assign income, and roughly half of the states use a variant of the combined report method.

STATEMENT PURSUANT TO RULE 37

This brief is submitted pursuant to Rule 37.3 of this Court in support of Respondent, the Director, Division of Taxation, State of New Jersey. Consent to the filing of this brief has not been requested from the parties because the amici filing this brief are the Attorneys General of their respective states and because of the invitation of this Court contained in its order of March 11, 1992. Rule 37.5 U.S. Sup. Ct.

SUMMARY OF ARGUMENT

The Court should overrule its decisions in *ASARCO* and *Woolworth* for all the reasons set forth by the dissent in those cases and for other reasons as well. Those cases, argued and decided in tandem, are aberrations. They are inconsistent with the large body of decisions issued by this Court which have given rise to the unitary business principle. This body of decisional law which constitutes the unitary business principle both predates and postdates *ASARCO* and *Woolworth*.

The question addressed in *ASARCO* and *Woolworth* was a narrow one: Under what conditions could a nondomiciliary state include dividends in the apportionable income base of the shareholder. Those cases addressed this question in a framework which was analytically and/or factually flawed. New Jersey and amici California, et al., are asking this Court to address the issue, which it treated Idaho as conceding in *ASARCO*, of whether it is necessary for the activities of the issuer of an intangible and the activities of the holder of an intangible to be unitary for income arising from

the intangible to be apportionable as to its holder. Amici submit that such a relationship is not required. Amici further submit that this is a "scope of the unitary business" question and that the correct inquiry involves determining whether the income arises in connection with the conduct of the unitary business of the taxpayer.

Apportionability should be established by and through the activities of the holder of the intangible. If the activities of the issuer and the activities of the holder are "unitary," then the income is invariably apportionable. It is apportionable, however, not because the issuer and holder are "unitary," but because the income arises from the activities of the holder which are part of the unitary business. The correctness of this result can be illustrated by considering the type of income involved in the present case: capital gains. The issuer of the underlying security has no income from the trading of its securities and therefore no tax. It is only the holder which has income and therefore tax, and it is only the holder's activities which can determine apportionability.

The overruling of *ASARCO* and *Woolworth* would eliminate the major source of confusion in this Court's "unitary business principle" jurisprudence. This Court does not need to fashion new constitutional standards for the evaluation of state taxes, however. Removal of the confusion created by *ASARCO* and *Woolworth*, will reestablish a sound and workable framework for evaluating the New Jersey assessments.

The Due Process Clause and Commerce Clause provide limitations on the power of states to tax, not requirements as to how they must tax. New Jersey, in its argument to this Court on March 4, 1992, correctly pointed out that application of the analytical framework of the "unitary

business principle" to state tax cases can give rise to the need for an extended factual inquiry (Oral Argument, pp. 32-34). A simpler standard would obviate the need for this inquiry which this Court in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), characterized as "long and complex and [where] the line between 'historical fact' and 'constitutional fact' is often fuzzy at best. Cf. *ASARCO*, 458 U.S. at 326-328, nn. 22, 23." 463 U.S. at 176. Because this Court is speaking to limitations and not requirements, it may wish to accept New Jersey's suggestion of the simpler rule of full apportionability in the single entity context.

Amici, however, ask this Court to keep in mind in considering this question that the case before it involves a "single entity" state, not a "combined report" state. In the "single entity" circumstance, there is no question that the first element of the Due Process Clause requirement—"minimal connection"—is satisfied. In the "combined report" circumstance, however, a state, while not taxing entities which are not present within its boundaries, is nonetheless considering their income and apportionment factors. Under existing unitary business principles, there is no unanswered question as to whether application of the combined report method is constitutionally permitted except for the reservation expressed in *Container* with respect to its application to foreign country-based businesses. 463 U.S. at 189 n. 26 and 195 n. 32. If the unitary business principle is abandoned or altered significantly, these questions may arise again. With these reservations and considerations in mind, amici endorse New Jersey's effort to obtain relaxed constitutional limits upon state taxing authority.

ARGUMENT

I

THE DECISIONS OF THIS COURT IN *ASARCO* AND *WOOLWORTH* SHOULD BE OVERRULED

A. INTRODUCTION

In *ASARCO* and *Woolworth*, the Court applied settled principles of constitutional Due Process Clause and Commerce Clause analyses to decide a narrow issue, the apportionability of dividends. These cases were before the Court on factual, *Woolworth*,[2] and analytical, *ASARCO*,[3] predicates which were flawed. The dissent in both *ASARCO*, 458 U.S. at 331-353, and *Woolworth*, 458 U.S. at 373-374, recognized these flaws and correctly concluded that the cases should have been decided differently. In addition, subsequent decisions of the Court (*Container*, *Shell Oil* and *Amerada Hess*. See discussions and citations *infra* at pp. 11-15) have rejected

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[2] In *Woolworth*, the Court noted that the New Mexico Supreme Court had "observed that, 'regrettably, it needs to be said that the State did a very poor job of inquiring into and developing the facts in this case.'" 458 U.S. at 360.

[3] In *ASARCO*, the Court stated "Neither does it [Idaho] question that a unitary business relationship between ASARCO and these subsidiaries [the dividend payors] is a necessary prerequisite to its taxation of the dividends at issue." 458 U.S. at 325. It should also be noted that in the Idaho Supreme Court, the primary issue was the combined reporting treatment applied to the unitary subsidiaries. The treatment of the dividends was only an ancillary issue. *American Smelting & Refining Co. v. Idaho State Tax Com.*, 102 Idaho 38, 624 P.2d 946 (1981).

elements of the *ASARCO* and *Woolworth* majority's analysis in two areas—the significance of the potential for control and the need for a direct connection between in-state and out-of-state activities—providing further support for overruling these decisions. Overruling the holding of these decisions on the narrow issue presented would not require this Court to overrule or abandon the settled principles of constitutional analysis set forth in the preamble of *ASARCO*, 458 U.S. at 315-320.

Prior to engaging in an analysis of why *ASARCO* and *Woolworth* should be overruled, amici believe it is important for the Court to recognize the different components of the unitary business principle analysis as set forth in their original brief filed in this matter (Brief of Amici California, et al., pp. 6-9). These components are: (1) the scope of the unitary business, (2) the income arising from the unitary business, and (3) the apportionment formula. Each of these components can require a different analysis although there can also be common threads to the analysis of each. Confusion as to whether *ASARCO* and *Woolworth* involved the **scope** or **income** component colored the Court's analysis and led to an erroneous result. As indicated in Amici California, et al.'s previous brief, this confusion led to the application of the analytical framework of the **scope** component to what should have been analyzed pursuant to the analytical framework of the **income** component.

B. APPORTIONABILITY OF DIVIDEND INCOME, OR ANY INCOME FROM AN INTANGIBLE, SHOULD NOT BE DETERMINED SOLELY BY REFERENCE TO THE RELATIONSHIP BETWEEN THE ACTIVITIES OF THE ISSUER AND THE ACTIVITIES OF THE HOLDER

The principal question involved in *ASARCO* and *Woolworth* was whether, in order to sustain the inclusion of dividends in apportionable income, it is necessary for the activities of a payor to be unitary with the activities of the payee. In *ASARCO*, this question was viewed as having been conceded by the State, and the majority opinion's analysis reflects this concession. With this concession, the outcome was a foregone conclusion. New Jersey and amici do not concede this question. Proper analysis establishes the error of the concession and the need to overrule both of these cases.

The relevant inquiry in determining whether an item of income arising from an intangible[4] is apportionable is the relationship of the holding of the intangible to the business of the holder. Only the holder of the intangible has income; therefore, only the holder should be taxed. There is no <u>necessary</u> relevance of the activities of the issuer of the intangible in determining the apportionability of the income in the hands of the holder. For further discussion, see Brief of Amici California, et al., pages 10-21.

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[4] The logic of this analysis is not restricted just to income arising from the holding of an intangible, it applies to all items of income. For purposes of this discussion, however, the focus is solely upon intangibles.

This does not mean that the relationship of the intangible, or item of income, to the activities of the holder can never be established by examining the relationship between the activities of the holder and the activities of the issuer. If there is a unitary relationship between the activities of the issuer of an intangible and the holder of the intangible, then the apportionability of the income is invariably established.[5]

It does mean, however, that an operational relationship between the activities of the holder of an intangible and the activities of the issuer of the intangible is not the exclusive means of determining apportionability. The activities of the issuer and holder need not be unitary for the income arising from an intangible to be apportionable. Examples of such circumstances are provided in the brief previously filed by Amici California, et al., on pages 16-17.

An examination of the treatment of capital gains, the issue directly involved herein, illustrates the fallacy of the requirement of an issuer/holder unitary relationship. This is not to say that dividends and capital gains require a different analysis or that a different result is required depending on the type of receipt. To the contrary, the fact that the analytical framework used for the dividends in *ASARCO* is inapplicable to capital gains proves that it was faulty. In the case of capital gains arising from the ownership of stock, the issuer of the stock has no earnings when the stock is bought and sold

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[5] If the activities of the payor and the activities of the recipient are part of the same unitary business, a scope-of-the-business analysis, then either the dividends would be apportionable income in the hands of the recipient or, if the combined report methodology was employed by the state, all of the income of the payor and its apportionment factors would be considered by the taxing state, and the dividends would be eliminated or disregarded.

by the third parties. The gains realized, or losses sustained, may reflect the outside world's view of the results of the issuer's activities, or they may have no relationship whatsoever; e.g., merger mania may have been partially involved in creating the gain in this case. The point is, the third-party seller is the only entity which has income, in both a taxable and economic sense, and therefore is the only entity which can be assessed a tax on those results. Thus, the apportionability of income is properly decided solely by reference to the taxpayer/recipient's activities.

C. CORPORATE PURPOSE IS THE CORRECT STANDARD FOR DETERMINING THE APPORTIONABILITY OF INCOME

A state, in assessing a tax on or measured by income, looks to the income of the taxpayer. With respect to a taxpayer which is not domiciled or organized within its boundaries, the state may tax only that income which is determined to be related to activities within its boundaries. This amount has normally been determined through apportionment.[6] In determining whether an item of income can be considered, the state must look to some factor or factors. The only factors which are relevant are those relating

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[6] In some cases, this is determined by rules of allocation. This can occur when under the Uniform Division of Income for Tax Purposes Act the income is nonbusiness income, that is, it does not arise from the unitary business.

to the taxpayer, for it is its tax which is being determined and its income which is being considered.

This Court in *ASARCO* rejected too hastily "corporate purpose" as the test. 458 U.S. at 326-329. "Corporate purpose," correctly defined, is the proper standard for determining apportionability. "Corporate purpose" has meaning when it is understood as being controlled by the purpose for which the corporation holds the asset.[7] For example, if the taxpayer holds itself out as actively engaged in acquiring, managing and disposing of intangibles as part of its operational business strategy and in furtherance of its operating business, then a state can, consistent with the requirements of Due Process analysis, conclude that it is generating "business income" from such activities.

D. SUBSEQUENT DECISIONS OF THE COURT HAVE OVERRULED OR SEVERELY LIMITED TWO MAJOR POINTS OF THE MAJORITY'S ANALYSIS IN *ASARCO* AND *WOOLWORTH*

1. Introduction

As a preliminary matter, it should be noted that both of the points which have been limited, and which are discussed hereinafter, relate to a scope-of-the-unitary-business inquiry, not to the apportionability of income, and therefore

[7] Perhaps the term "unitary purpose" or "business purpose" more accurately captures the distinction between apportionable and allocable income.

are not <u>necessarily</u> relevant to the determination of the question here at issue. (See Brief of Amici California, et al., pp. 6-9.) These points were discussed in *ASARCO* and *Woolworth* because the decisions analyzed the question presented as a scope-of-the-business approach, or as if the question presented was whether the payors of the dividends could have been included in a combined report. As discussed previously, pages 8-10, the inability to include a dividend payor in a combined report should not be a bar to treating the dividend as apportionable income. The Court's subsequent limitations on its analyses in *ASARCO* and *Woolworth* show the tenuous nature of these holdings.

2. Potentials

In *Woolworth*, this Court held that the New Mexico courts erred in making their unitary determinations "largely by emphasizing the potentials of the relationship. . . ." 458 U.S. at 363.[8] In effect, the Court was addressing a question involving the burden of proof and placing it upon the State. In so holding, the Court disregarded its prior holdings "that a taxpayer claiming immunity from a tax has the burden of establishing his exemption," *Norton Co.* v. *Department of Revenue*, 340 U.S. 534 (1951), and that in a unitary business principle analysis, the taxpayer must show that the activities sought to be excluded are part of a "discrete business

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[8] The potential unitary relationship was also involved in *ASARCO* but to a lesser extent. In that case, it was noted that there was sufficient ownership to control operations with respect to Southern Peru Copper, 458 U.S. at 320, and M.I.M. Holdings, 458 U.S. at 323, but that control was not exercised. In the case of other two-dividend payors, ASARCO owned less than 50 percent of the common stock.

enterprise," *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425 at 439 (1980).

In *Container*, the Court reaffirmed the burden of proof principles called into question by *ASARCO* and *Woolworth*. 463 U.S. at 175-176. In addition, the Court held that the state court in *Container* had done more than rely upon "mere *potential* to control," 463 U.S. at 177 (Court's emphasis), relying instead upon the stipulated fact "that '[h]igh officials of appellant gave directions to subsidiaries for compliance with the parent's standard of professionalism, profitability, and ethical practices.' [citations.]" This should not, however, be read as an endorsement of the proposition that "potential" is an insufficient standard. The Court's contrary intent is revealed in a footnote to its discussion where it went on to say: "In any event, although potential control is, as we said in F.W. Woolworth, not '*dispositive*' of the unitary business issue, id., at 362 [citations] (emphasis added), it is *relevant*, both to whether or not the components of the purported unitary business share that degree of common ownership which is a prerequisite to a finding of unitariness, and also to whether there might exist a degree of implicit control sufficient to render the parent and the subsidiary an integrated enterprise." 463 U.S. at 177 n. 16 (Court's emphasis).

3. Relationship of Out-of-State Activities to In-State Activities

In *ASARCO*, the Court suggested that in order for a state to consider an activity which occurred outside of its boundaries, it was necessary that it show that such activity was related directly to activities within its boundaries when it

stated that "ASARCO's Idaho silver mining and Southern Peru's autonomous business are insufficiently connected to permit the two companies to be classified as a unitary business." 458 U.S. at 322. The Court has specifically discussed this question in two subsequent cases and rejected it.

In *Shell Oil Company* v. *Iowa Department of Revenue*, 488 U.S. 19 (1988), the Court considered whether income earned from the sale of oil and gas extracted from the Outer Continental Shelf (OCS) could be considered by Iowa, a state with no ocean boundaries, in its apportionable base. In answering this question in the affirmative, the Court stated:

> "Shell's argument hinges on the mistaken premise that including OCS-derived income in the preapportionment tax base is tantamount to the direct taxation of OCS production. But income that is included in the preapportionment tax base is not, by virtue of that inclusion, taxed by the State. Only the fraction of total income that the apportionment formula determines (by multiplying the income tax base by the apportionment fraction) to be attributable to Iowa's taxing jurisdiction is taxed by Iowa." 488 U.S. at 30.

In *Amerada Hess Corp.* v. *New Jersey Department of Treasury*, 490 U.S. 66 (1989), the Court considered whether New Jersey could disallow deductions of the federal Windfall Profits Tax when there was no oil production within the state. The Court rejected the taxpayer's argument that a state could not disallow an exclusively out-of-state expense stating:

> "Appellants, however, underestimate the fact that, for apportionment purposes, it is inappropriate to consider the windfall profit tax as an out-of-state expense. Rather, just as each appellant's oil-producing revenue—as part of a unitary business—is not confined to a single State, [citations omitted] so too the costs of producing this revenue are unitary in nature. [Citations omitted] (the costs of a unitary business cannot be deemed confined to the locality in which they are incurred). Thus, when a State denies a deduction for a cost of a unitary business, the resulting net figure is still a unitary one, which a State may legitimately decide to apportion according to the standard three-factor apportionment formula. [Footnote omitted]." 490 U.S. at 74.

If the rule suggested in *ASARCO* is followed, then any particular unitary business will change its configuration from state to state depending upon the direct ties which exist to the activities in each separate state. This result simply makes no sense and is contrary to the Court's upholding in *Container* that "a State not tax a purported 'unitary business' unless at least some part of it is conducted in the State." 463 U.S. at 166. This requirement does not necessitate that activities in the taxing state have direct and separate ties to each out-of-state activity.

II

THE OVERRULING OF *ASARCO* AND *WOOLWORTH* SHOULD BE RETROACTIVE IN EFFECT

ASARCO and *Woolworth* closely followed in time *Mobil*, and immediately preceded *Container*. *ASARCO* and *Woolworth*, however, are aberrations and cannot truly be reconciled with either *Mobil* or *Container*, or any of the other cases in this area, except by distinguishing on the basis of inadequately developed factual records (*Woolworth*, and to a lesser degree, *ASARCO*) or analytical concessions viewed as having been made by the losing party (*ASARCO*). *ASARCO* and *Woolworth* should be discarded as precedential authority.

Because of the unique circumstances of *ASARCO* and *Woolworth*, their overruling was clearly foreshadowed, even at the time they were rendered,[9] and was effectively accomplished by *Container*. Amici endorse the position set forth by Amici Virginia, et al., to be filed concurrently herein as to the appropriate standard for resolving retroactivity. The standards for retroactive application of the overruling of *ASARCO* and *Woolworth* are met.[10]

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[9] *Mobil*, 445 U.S. 425.

[10] An argument can be made that the question in this case is not whether a decision in favor of New Jersey and overruling *ASARCO* and *Woolworth* should be retroactive, but whether those cases should be applied retroactively to limit the assessment of the tax proposed herein. The transaction which gave rise to the tax here at issue occurred in 1981, prior to the Court's decision in *ASARCO* and *Woolworth*.

III

THE UNITARY BUSINESS PRINCIPLE AS INTERPRETED IN THIS COURT'S DECISIONS, OTHER THAN *ASARCO* AND *WOOLWORTH*, SHOULD ESTABLISH THE LIMITS ON STATE TAXATION OF CORPORATIONS DOING BUSINESS IN SEVERAL STATES

A. INTRODUCTION

In considering this question, it is important to keep in mind the difficulties inherent in determining the appropriate amount of income to assign to a state. These difficulties were recognized in the first unitary income tax case, *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920), where the Court at 120-121 stated:

> "The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut, and ending with sale in other states. In this it was typical of a large part of the manufacturing business conducted in the state. The legislature, in attempting to put upon this business its fair share of the burden of taxation, was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders."

These difficulties were also commented upon in *Container*, where this Court compared the allocation of income among various taxing jurisdictions to the task of "slicing a shadow." 463 U.S. at 192. In comparing formulary apportionment with arm's-length/separate accounting, the only alternative suggested, this Court in *Container* stated:

> "One way of deriving locally taxable income is on the basis of formal geographical or transactional accounting. The problem with this method is that formal accounting is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise. See generally Mobil Oil Corp., supra, at 438-439, [citations omitted] and sources cited. The unitary business/formula apportionment method is a very different approach to the problem of taxing businesses operating in more than one jurisdiction. It rejects geographical or transactional accounting, and instead calculates the local tax base by first defining the scope of the 'unitary business' of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that 'unitary business' between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's

activities within and without the jurisdiction. This Court long ago upheld the constitutionality of the unitary business/formula apportionment method, although subject to certain constraints. See, e.g., Hans Rees' Sons, Inc. v. North Carolina ex rel Maxwell, 283 U.S. 123 (1931) [citations omitted]; Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, supra; Underwood Typewriter Co. v. Chamberlain, supra. The method has now gained wide acceptance, and is in one of its forms the basis for the the [sic] Uniform Division of Income for Tax Purposes Act (Uniform Act), which has at last count been substantially adopted by 23 States, including California." 463 U.S. at 164-165.

This comparison leads inescapably to the conclusion that in determining the amount of income which a state can consider, states should continue to have the option of choosing a formulary apportionment mechanism of some kind.

B. THE UNITARY BUSINESS PRINCIPLE IS AN APPROPRIATE STANDARD FOR DETERMINING THE APPORTIONABILITY OF INCOME

The unitary business principle has been a fixture in state taxation for over one hundred years. It was first applied in the area of property taxation. Shortly after the advent of state corporate income taxes, the unitary business principle was sanctioned for use by this Court as a means of dividing the income tax base among various jurisdictions. *Underwood*,

254 U.S. 113. It has a long history of acceptance and is employed in some form by every single subnational jurisdiction in this country which asserts an income tax.

This Court's decisions, with the exception of *ASARCO* and *Woolworth*, to which your first inquiry was directed, have been evolutionary in nature. Each subsequent decision has built upon the framework established in prior cases, adapting to changes in the manner in which businesses operate.

The major cases in this evolutionary series include:

> *Underwood Typewriter*, 254 U.S. 113 (1920), which addressed the circumstance of a single corporation's activities involving the manufacture of a product in one state with sales in several states.
>
> *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission,* 266 U.S. 271 (1924), which involved a single corporation manufacturing a product in another country and selling in several states.
>
> *Butler Brothers* v. *McColgan*, 315 U.S. 501 (1942), which involved a single corporation with a central buying office in one state and distribution centers in a number of states.
>
> *Mobil Oil Corp*. v. *Vermont*, 445 U.S. 425 (1980), which was the first case to deal with the multiple entity pattern, "foreign source" income and, specifically, the taxation of income

arising from intangibles held as an asset of the operating business.

Container Corporation of America v. *Franchise Tax Board*, 463 U.S. 159 (1983), which squarely addressed the questions presented by the multicorporate business with international operations.

Shell Oil Company v. *Iowa Department of Revenue*, 488 U.S. 19 (1988) and *Amerada Hess Corp.* v. *New Jersey Department of Treasury*, 490 U.S. 66 (1989), which established the principle that there is no requirement that an item of income arise or an expense be incurred directly in a state for it to be considered as part of unitary income.

The most significant of these cases is *Container*. It summarizes prior precedent and deals with *ASARCO* and *Woolworth*. It is a "capstone" opinion. The Court should re-endorse the principles reiterated therein.

These principles, taken from *Container* and other cases, include the following:

Due Process Clause and Commerce Clause analyses establish principles of limitation upon state taxation but do not establish requirements for state taxation. "[T]here are variations on the theme, and any number of them are logically consistent with the underlying principles motivating the approach."

Container, 463 U.S. at 167. "[T]he Constitution imposes no single formula on the States. *Wisconsin* v. *J.C. Penney Co.*, 311 U.S. 435, 445 (1940)." *Container*, 463 U.S. at 164.

"[T]here is a 'minimal connection' or 'nexus' between the interstate activities and the taxing State and 'a rational relationship between the income attributed to the State and the intrastate values of the enterprise.' *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, [447 U.S. 207 at 219-220 (1980)]." *Container*, 463 U.S. at 165-166.

A tax, to be constitutional, must be applied to an activity with a substantial nexus with the taxing state, be fairly apportioned, not discriminate, and be fairly related to the services provided by the state. *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 at 279 (1977).

Due Process Clause and Commerce Clause nexus is established by the fact that some part of the unitary business is conducted in the taxing state. *Container*, 463 U.S. at 166.

The unitary business principle and formula apportionment is a "proper and fair method of taxation." *Container*, 463 U.S. at 184.

The taxpayer has the burden to prove "by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportion to the business transacted . . . in that State' [*Hans Rees' Sons, Inc.* v. *North Carolina ex rel Maxwell*, 283 U.S. 123 at 135 (1931)] or has 'led to a grossly distorted result,' [*Norfolk & Western R. Co.* v. *Missouri State Tax Comm'n*, 390 U.S. 317 at 326 (1968)]." *Moorman Mfg. Co.* v. *Bair*, 437 U.S. 267 at 274 (1978).

The taxpayer must show that the activities to be excluded are part of a "discrete business enterprise." *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425 at 439 (1980).

"In the case of a more-or-less integrated business enterprise operating in more than one State . . . arriving at precise territorial allocations of 'value' is often an elusive goal, both in theory and practice." *Container*, 463 U.S. at 164. Rough approximation is all that is required. *International Harvester Co.* v. *Evatt*, 329 U.S. 416 (1947).

None of these principles is compromised to the slightest extent by an overruling of *ASARCO* and *Woolworth*; therefore, there is no reason to abandon them even if *ASARCO* and *Woolworth* are overruled. To do so would be tantamount to throwing the baby out with the bathwater.

C. THE NEW JERSEY ASSESSMENTS CAN BE SUSTAINED UNDER A BURDEN-OF-PROOF ANALYSIS WITHOUT REQUIRING AN ABANDONMENT OF THE UNITARY BUSINESS PRINCIPLE

In applying these principles to the case before this Court, it should be recognized that New Jersey is a "single entity" state. It does not use the "combined report" approach. In a "single entity" state, the state looks only to the results of each single corporate entity which is present within its boundaries in determining the income base subject to formulary apportionment. In a "combined report" state, the state will look beyond individual corporate boundaries in determining the amount of income which is to be included in the income base subject to apportionment. (See argument D, *infra*, for the analysis in a combined report environment.)

The difference in corporate form chosen by a business may lead to a different tax result in a "single entity" state such as New Jersey than it would in a "combined report" state. These practical consequences are permissible, *Container*, 463 U.S. at 167-169, and have significance in the context of the burden of proof.

A taxpayer can control its tax exposure in New Jersey by the simple expediency of establishing wholly owned subsidiaries. If Bendix had chosen to hold its interest in ASARCO in a separately incorporated subsidiary which had no direct contact with New Jersey, New Jersey would not now be laying claim to an apportioned share of the gain. If New Jersey were a combined report state, it would. When this practical difference is combined with the principle that a taxpayer has the burden of showing that the state tax

assessment is out of all appropriate proportion to the activities done with the state, *Hans Rees' Sons, Inc.* v. *North Carolina ex rel Maxwell*, 283 U.S. 123, 135 (1931), and the duty to show that the activities to be excluded arise from a "discrete business enterprise," *Mobil*, 445 U.S. 425, different results may arise in the "single entity" as compared to the "combined report" setting because of burdens of proof. These differences are not necessarily of a constitutional dimension but are real nonetheless.

If Bendix wished to establish that its ownership of shares of ASARCO was a "discrete business enterprise," the New Jersey law provided it with a failsafe method—separate incorporation. Bendix did not use the method provided by New Jersey. New Jersey and its courts drew a logical conclusion from that failure—the ownership of the ASARCO shares was not part of a "discrete business enterprise." Bendix had the opportunity to refute this conclusion and did not do so. Therefore, the New Jersey assessments should be sustained.

Sustaining the New Jersey assessments in this case does not require the Court to abandon the unitary business principle and adopt a mandatory rule of full apportionment within a single corporate entity. The Court need merely recognize that the Due Process Clause does not prohibit the New Jersey approach. Other approaches which do not extend so far, e.g., business/nonbusiness and separate line of business statutory distinctions, would remain permitted. Amici concur with New Jersey's representative (Transcript of Oral Argument, March 4, 1992, pp. 32-34) that unnecessary application of the unitary business principle in the circumstances of this case may give rise to extensive discovery

and protracted disputes over which activities are part of the unitary business.[11]

D. EVEN IF THE COURT HOLDS THAT APPLICATION OF THE UNITARY BUSINESS PRINCIPLE IS UNNECESSARY IN THE CIRCUMSTANCES OF A SINGLE ENTITY, THE UNITARY BUSINESS PRINCIPLE SHOULD BE PRESERVED FOR COMBINED REPORT PURPOSES

The purpose of the "combined report" approach is to prevent a business from manipulating its state tax results by the use of separate corporate forms. The California Supreme Court explained it as follows in *Edison California Stores* v. *McColgan*, 30 Cal.2d 472 at 479-480, 183 P.2d 16 (1947):

> "In the present case all of the elements of a unitary business are present—unity of ownership, unity of operation by centralized purchasing, management, advertising and accounting, and unity of use in the centralized executive force and general system of operation. The business of the parent and all

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[11] A simple ownership rule might well alleviate this particular factual inquiry undertaken under both the Due Process Clause and Commerce Clause but could give rise to an alternative Commerce Clause inquiry—whether the apportionment formula fairly reflects the activities which gave rise to the income, or what this Court in *Container* termed the "external consistency" test, 463 U.S. at 169—but based upon the same essential facts. It is not, however, present in this case and therefore there is no need for the Court to consider it in deciding the issue before it.

of its subsidiaries is owned and managed under one centralized system, to the same extent as in the Butler Brothers case and other cases considered therein. Thus the business is unitary regardless of the fact that in the Butler Brothers case there was but one corporation involved, owning as parts of the unitary system seven different branches in as many states, and that in the present case there is a parent corporation owning and controlling as units of one system fifteen different branches organized as corporations in as many states. No difference in principle is discernible. If the crux of the matter is to ascertain that portion of the business which is done within this state, then the same considerations justify the use of the formula allocation method in the one case as in the other."

In *Container*, 463 U.S. at 168, in discussing the unitary business concept as applied to a multi-corporate unitary business, the Court, quoting *Mobil*, stated:

"'Superficially, intercorporate division might appear to be a[n] . . . attractive basis for limiting apportionability. But the form of business organization may have nothing to do with the underlying unity or diversity of business enterprise.' *Id.*, at 440."

The use of a combined report is a scope-of-the-business question in its clearest form. The income and factors of a separate corporation are includable only if they are within the unitary business carried on by the corporate entity present in the taxing state. The tests for inclusion invariably include a requirement of controlling ownership, as was illustrated by the treatment proposed by the State of Idaho with respect to ASARCO and its various related entities, 458 U.S. at 312-314. The combined report question presents a different question than whether dividends are apportionable. (See pp. 8-10, *infra.*) In *Mobil*, the Court permitted Vermont to include dividends received, principally from Aramco in which Mobil held only a ten-percent interest,[12] in apportionable income. No one suggested that Mobil's Aramco interest should give rise to a combined report including all of Mobil's and Aramco's income and activities.

In the circumstance of a single entity, the requisite jurisdictional nexus for Due Process purposes is supplied by its presence. Clearly, the single entity is present in the state or no tax would be assessed. In the combined report context, however, a state, though not taxing entities which are not present within its boundaries, nonetheless considers their income and activities and the question of jurisdictional nexus becomes more significant. If the parent corporation is present in the taxing state, the ownership ties with its subsidiaries may be sufficient to also allow for jurisdictional nexus to be established. If it is, however, only a subsidiary which is present within the state, the "upstream" jurisdictional nexus may be more problematical. In these circumstances, this

[12] 445 U.S. at 430 n. 5.

Court has relied upon the unitary business principle to establish the required jurisdictional nexus. *Container*, 463 U.S. at 165-166. Loss of this jurisdictional nexus could provide a blueprint for wholesale state tax manipulation by corporate taxpayers. The very problems which were originally addressed by California when adopting the combined report procedure could be reinstated with a constitutional imprimatur of legitimacy. A taxpayer, relying solely on its ability to control its corporate structure and domicile, could manipulate its state tax payments. Form would triumph over substance. Amici respectfully submit that this is not a result which this Court should countenance.

CONCLUSION

The decision of the New Jersey Supreme Court should be sustained and the decisions of this Court in *ASARCO* and *Woolworth* should be overturned.

The Court should reaffirm its commitment to the constitutional standards set forth in *Complete Auto Transit*, 430 U.S. 274 (1977)[13] and *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980)[14], and to the unitary business principle. It should affirm that these are principles of limitation on state action and not requirements for state action. In the circumstances of this case, where the apportionability of the income of a single entity is at issue, a relaxation of the unitary business principle would not run afoul of the Constitutuion. If such a relaxation is adopted, it should be limited to the circumstances of this case so as not

[13] Nexus, fair apportionment, nondiscriminatory, and fairly related.
[14] Minimal connection and rational relationship.

to eviscerate the combined report method. A taxpayer should not be allowed to manipulate its state tax results through the use of the corporate form.

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